

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

AUDIT REPORT
OF

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
STATE OF INDIANA

July 1, 2003 to June 30, 2004



TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Agency Officials.....	2
Transmittal Letter	3
Audit Results and Comments:	
Internal Control Structure and Environment	4-5
Legal Settlement Issued	5
Checking Accounts – Cash Necessary to Balance.....	5-6
Reserve Reconcilements.....	6-9
Investment Accounting and Transfers	9-10
Mutual Fund Taken Out of CRIF.....	10-11
Mutual Fund Investments	11
Financial Accounting and Reporting	12-13
Legislators' Defined Contribution Fund Not Reconciled	13
Benefit Expense.....	14
Tax Withholding Remittance Errors	14-15
Accounting for Void Checks.....	15-16
Check Issuance Procedures.....	16
Lack of Controls – Manual Checks	16-18
Internal Control Over Contribution Revenue Collections	18-19
1977 Police and Fire Fund Contributions	19
Judges Contributions	20
Lack of Benefit Transaction Accounting	20-21
Benefit and Refund System Control Weaknesses.....	21-22
Overpayment of Benefits – Early Retirement Factor	22
Underpayment of State Employee Disability Pensions.....	23
Final Annuity Savings Account Contributions Not Paid	23-24
Final Quarter Interest Not Paid	24-25
Incorrect Monthly Benefits	25
Retroactive PERF Disability Benefits.....	25-26
Incorrect Refunds - Death In Service	26-27
Unpaid Retroactive Benefit	27
Employer Reserve Charges.....	27-28
Interest Credit to 1977 Fund Members	28-29
Prosecuting Attorneys' Disability Retirement	29
Exit Conference	30
Official Response	31-35

AGENCY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Executive Director	Mr. Craig Hartzler	07-01-03 to 01-10-05
Acting Executive Director	Mr. Bruce Kimery	01-11-05 to 03-07-05
Executive Director	Mr. David Adams	03-08-05 to 06-30-05
Chairman of the Board	Mr. Jonathan Birge	11-09-01 to 04-08-05



STATE OF INDIANA

AN EQUAL OPPORTUNITY EMPLOYER

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2765

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

TO: THE OFFICIALS OF THE PUBLIC EMPLOYEES' RETIREMENT FUND

We have audited the financial statements of the Public Employees' Retirement Fund Board of Trustees as of and for the year ended June 30, 2004, and have issued our opinion thereon dated February 22, 2005. The financial transactions of this office are reflected in the Public Employees' Retirement Fund of Indiana's Comprehensive Annual Financial Report.

In planning and performing our audit, we considered the internal controls over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain conditions in the design or operation of one or more of the internal control components that, in our judgment, could adversely affect the Board's ability to record, process, summarize, and report financial information or does not reduce to a relatively low risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We also noted certain issues of noncompliance with statutes, board policies, or contracts that in our opinion should be communicated to management.

The internal control conditions and the issues of noncompliance are disclosed in the following audit results and comments.

STATE BOARD OF ACCOUNTS

February 22, 2005

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004

INTERNAL CONTROL STRUCTURE AND ENVIRONMENT

An internal control structure is comprised of the control environment, risk assessment, control procedures, monitoring and the information and communication that are to occur throughout the processes. The control environment is the foundation for all other components of internal control.

In our prior six audit reports (most recently B22849), we disclosed that certain components of the Public Employees' Retirement Fund of Indiana's (PERF) internal control structure had not been designed or implemented in order to ensure that control procedures, information and monitoring occurred. The components identified included: reserve reconcilements; financial accounting and reporting; investment accounting and transfers; and checking account reconcilements. These areas were again found to have control weaknesses and findings that are detailed further in this report. Our prior report also found an inadequate overall internal control design and level of control consciousness both with respect to previously reported areas, as well as to the computer system that was implemented for retirement transactions in May 2002.

A material weakness in internal control is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, or irregularities in amounts that would be material for a fund may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. During the fiscal year ended June 30, 2004, in our judgment, there were nine conditions of material internal control weaknesses for the funds. These are further described in the following audit results and comments:

Checking Accounts – Cash Necessary to Balance
Reserve Reconcilements
Investment Accounting and Transfers
Mutual Fund Taken Out of CRIF
Mutual Fund Investments
Financial Accounting and Reporting
Check Issuance Procedures
Lack of Benefit Transaction Accounting
Benefit and Refund System Control Weaknesses

Three of the above conditions had transactions with amounts material to the funds that were considered irregular as unsubstantiated or without evidence of proper authority. These include: Reserve Reconcilements, Mutual Fund Taken Out of CRIF, and Mutual Fund Investments. Other findings of noncompliance as to legal requirements or the improper retention of funds are stated in:

Legal Settlement Issued
Judges Contributions
Interest Credit to 1977 Fund Members

There were seven findings with internal control weaknesses that represented a risk of undetected errors, misstatements, or irregularities that could have been significant to the funds affected:

Legislators' Defined Contribution Fund Not Reconciled
Benefit Expense
Tax Withholding Remittance Errors
Accounting for Voided Checks
Lack of Controls – Manual Checks
Internal Control Over Contribution Revenue Collections
1977 Police and Fire Fund Contributions

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

There were nine specific findings of conditions of inaccurate retirement benefits or refunds processed that had either remained uncorrected from the prior year, or were also continuing conditions of error processing. These were caused by system processing errors, manual errors, lack of adequate staff training, and lack of adequate monitoring of the final calculations. These nine conditions are reported as follows:

Overpayment of Benefits – Early Retirement Factor
Underpayment of State Employee Disability Pensions
Final Annuity Savings Account Contributions Not Paid
Final Quarter Interest Not Paid
Incorrect Monthly Benefits
Retroactive Perf Disability Benefit
Incorrect Refunds – Death In Service
Unpaid Retroactive Benefit
Prosecuting Attorneys' Disability Retirement

Additionally all funds had conditions of inaccurate funding of benefits that are described in the finding:

Employer Reserve Charges

By June 2004, PERF had identified and begun projects to address prior findings. Two CPA firms were contracted to: compile and reconcile cash and reserves; review and design internal control procedures, including the associated computer access; and recalculate retiree benefits.

IC 5-10.3-3-7.1 states: "The board shall annually analyze for internal control purposes the fund's; (1) income and expenditures; (2) actuarial condition; (3) reserve accounts; (4) investments; and (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

LEGAL SETTLEMENT ISSUED

A former employee, who left employment on October 16, 2003, was subsequently paid a total of \$212,000 in accordance with a settlement agreement executed by the executive director on November 7, 2003. Parameters for this settlement agreement were set during an executive session of the Board of Trustees on October 31, 2003. No final action on this settlement agreement was taken at an open meeting of the Board of Trustees.

IC 5-14-1.5-6.1, which covers executive sessions, clearly states in section (c) that, "A final action must be taken at a meeting open to the public."

CHECKING ACCOUNTS - CASH NECESSARY TO BALANCE

We stated in the three prior audit reports (most recently B22849) that our review of the checking account maintained for the benefits and refunds issued for the PERF, Judges', Prosecutors', Conservation and Excise Police Officers' and Legislators' Funds showed unexplained differences, and that reconciliations were not completed since December 2001. With the switch to the new retirement system (SIRIS) the outstanding checklist was either unavailable or inaccurate. We have stated in the past four audit reports that there were unexplained differences for the 1977 Fund checking account.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

No reconciliations of the PERF checking account had been made during the fiscal year ended June 30, 2004. This was communicated to management and, subsequent to fiscal year end, PERF contracted with a CPA firm to reconcile these accounts. This included compiling an outstanding check list, and comparing the bank records and disbursement records to the general ledger entries for bank deposits, benefit and refund expenses, and tax payments. The work was completed and made available to us in December 2004. We tested the work performed and communicated our findings of related identified adjustments.

As of June 30, 2004, we calculated cash necessary to balance of \$ 3,594,120 (net of tax overpayments) for the checking account maintained for the PERF, Judges', Prosecutors', Conservation and Excise Police Officers' and Legislators' Funds. The total balance of the overpaid taxes for those funds was \$2,779,773. PERF recorded adjustments to recognize the overpaid tax withholdings, which had accumulated during fiscal 2003 and fiscal 2004. PERF also recorded a cash decrease of the amount necessary to balance by recording a benefit expense of \$3,594,120 in fiscal 2004. The general ledger entry was used to balance the account, as there were no associated benefit expenses to support the entry made. The cause of the cash checking account shortage was not identified.

Monthly bank reconciliations were not performed from October 2003 to June 2004 for the checking account maintained for the 1977 Police Officers' and Firefighters' Pension and Disability Fund and the Pension Relief Fund. During this time, the fund transitioned to use of the SIRIS for its outstanding check list. The final reconciliation did not account for taxes owed as of June 30, 2003, of \$54,840, which were not recorded on the ledger, and which had not been paid during fiscal 2004. Omitting the tax condition from the prior year, the cash necessary to balance the account at June 30, 2004, was \$4,386. An adjustment was recognized to decrease cash in the 1977 Fund general ledger by an entry as a benefit expense. PERF could not explain the reason for omitting the taxes owed that they had calculated at June 30, 2003. The cause of the cash checking account shortage was not identified.

Each agency is responsible for maintaining an effective and accurate accounting system for subsidiary and supplementary records. At all times, the agency's manual and computerized records, subsidiary ledgers, control ledger, and reconciled bank or auditor's balance should agree. If reconciled bank or auditor's balance is less than the subsidiary or control ledgers, then the responsible official or employee may be held personally responsible for the amount needed to balance.

RESERVE RECONCILEMENTS

Prior Audit Report (B22849) - Fiscal 2003

For each fund administered as of June 30, 2003, the member and employer reserves had unidentified variances between the subsidiary computer system records and the general ledger balances that were either significant or material to the fund.

In our prior five audit reports, we stated that the subsidiary ledgers for employee and employer accounts were not reconciled to the reserve balances maintained on the general ledgers. We recommended that PERF reconcile on a timely basis the subsidiary ledgers for employee and employer accounts to the reserve balances maintained on the general ledgers. From July 2000 to March 2002, no reconciliations were performed. During this time, a critical system conversion occurred. Prior to that time, and thereafter, incomplete reconciliations were performed with resulting unidentified variances.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

Factors that cause continued incomplete reconcilements include the following:

- (1) Lack of research to identify variances that continue from prior periods.
- (2) Monitoring and research as to system entries is impeded by the lack of audit trails of system transactions to support or identify the composition of grand totals reported.
- (3) The system accounting entries have not been defined. A listing of automatic computer generated entries was not provided or available. Certain entries could not be explained by either PERF or computer design consultants.
- (4) Known system failures in reporting accurate totals were identified due to the material totals involved. Smaller system variances could occur on an ongoing basis and remain undetected.
- (5) Lack of procedures to identify the total contributions received that have not been posted to SIRIS.
- (6) Monthly reconcilements were performed by the same accountant responsible for general ledger entries.
- (7) Incomplete accounting for manual checks issued.

The lack of timely reconcilements may allow errors on the general ledgers or system programming problems on SIRIS to go undetected. This could result in undetected fraud, incorrect transfers for members' investment options, or misstated reserve balances.

Fiscal 2004

The conditions remained as described above during fiscal 2004. PERF hired a CPA firm to reconcile reserve transactions for fiscal 2003 and 2004. The status of the prior identified conditions and related findings are as follows:

- (1) On December 17, 2004, the PERF Board of Trustees minutes indicated they approved general ledger adjustments with a net total of \$125 million. These were entered in the general ledgers of all pension funds administered effective as of June 30, 2004. The project adjustment summary indicated that this was comprised of: a net addition to employers reserve for an identified prior period adjustment from fiscal 2000 of \$147 million; \$304 million reduction in employer and employee reserves to agree retirement funding to that recorded on the SIRIS accounts for two years; and an addition to employee reserves of \$32 million for variances in amounts recorded to the SIRIS from that of the general ledger for two years. Other prior period adjustments were recognized that were between the employee and employer reserves, and as such were netted to zero in the summary totals.

A net total of \$112.4 million was also added to the employer and employee reserves for amounts necessary to balance to the grand totals of the data files for members and employers accounts on SIRIS at June 30, 2004. The \$112.4 million was provided from the undistributed reserve. According to the reconciliation project, the unidentified variances largely existed as of June 30, 2002.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

The reconciliation project also identified a net total of \$1.3 billion that should be removed from SIRIS employer account balances. This is comprised largely of reversals of income distributions recorded for years in which there were losses and to record several years of actuarial and administrative costs.

- (2) There were inadequate audit trails. Audit trails of system transactions enable tracing to and from the source that supports the entry. This is necessary for internal control procedures, as well as for research, monitoring, and audits. In the course of business, such information would be used in procedures designed to ensure the validity of transactions. As of February 2005, PERF identified that the audit trails to enhance monitoring and research efforts remained in progress.

We have found SIRIS account entries for refunds and retirements that do not agree with source transactions. These include unsupported entries and entries that vary from the amounts paid or applied in annuity calculations.

Certain audit trails were not provided to the CPA firm for the reconciliation project. The source information omitted from data base extracts included: member records omitted the employer reference that remitted payment; and employer records omitted identity of the member retirements. Subsequent to our field work, the full employer records were provided to us.

- (3) In order to assess completeness of audit trails, the system entries require full definition of how the amounts are calculated and the related accounting effects.

The system accounting entries remain undefined. The reconciliation project obtained electronic files of SIRIS general ledger extract reports, and SIRIS member and employer account detail (data files). The SIRIS system accounting entries could not be agreed to the data base transactions. In order to compile the reserve adjustments, the CPA firm compiled totals from the data files.

The documentation of the entire SIRIS system remains incomplete. The definition, source, and timing of recognition have not been identified for either the SIRIS accounting entries or the SIRIS member and employer account transaction types. Each SIRIS transaction performed has not been associated to the reports, screens or data bases. Other transactions, such as payments for prior service credit, were found to have not been recorded in SIRIS as the correct accounting has not been determined.

Unexplained variances exist between the SIRIS employer summary report and the data file of employer account detail. A question also remains as to the employer receivable balances maintained within SIRIS which have material amounts.

- (4) As of February 2005, PERF reported the status of this finding and included that the "system fix in reporting accurate totals (material totals involved)" was in progress.

During fiscal 2004, we found \$176 million had been recorded as actuarial retirement costs from a PERF employer account entitled "employer unidentified." Three deceased retirees were referenced as associated to these transactions, for which there were no payments made. The CPA firm found retirement charges recorded to the PERF employer account for Jackson County of \$874 million, and to a hospital's account for \$7 million. These are considered to be inaccurate totals.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

Smaller system variances could occur on an ongoing basis and remain undetected.

- (5) As of February 2005, PERF reported that the status of procedures to identify total contributions received but not posted to SIRIS as in progress.
- (6) An accounting position was added and entitled reconciliation accountant. The duties as related to reserves were not in place at June 30, 2004.
- (7) The incomplete accounting for manual checks issued continued. Benefits paid manually have not been funded. Refunds issued from manual checks through October 2003 have not been verified or agreed to SIRIS entries to remove the members account balances.

As a result of project findings that the SIRIS general ledger extract reports do not agree to the SIRIS employee and employer account activity, it was concluded that the SIRIS general ledger was not functioning. When considered in conjunction with our findings of other failed reports and lack of transaction output controls, the risk of an incorrect acceptance of undetected errors or fraud is increased significantly.

IC 5-10.2-2-2 directs that the Board of Trustees of the Public Employees' Retirement Fund shall establish separate accounts designated the retirement allowance account and the annuity savings account. IC 5-10.2-2-6 further requires separate accounts for employer contributions from the state and each political subdivision be maintained within the retirement allowance account.

IC 5-10.3-3-7.1 provides that:

"The board shall annually analyze for internal control purposes the fund's;

- (1) income and expenditures;
- (2) actuarial condition;
- (3) reserve accounts;
- (4) investments; and
- (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

INVESTMENT ACCOUNTING AND TRANSFERS

As stated in five prior audit reports (most recently B22849), PERF did not have procedures in place to ensure that: contributions are deposited in the appropriate investment accounts and are recorded in the correct fund's unitized owner account; transfers are between authorized accounts; transactions are in compliance with Board decisions and directives; and a timely review of custodian bank reports has occurred. Evidence of such controls and results should also be established and communicated to management on a regular basis, and made available for audit.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

During the fiscal year ended June 30, 2004, we found instances of contributions that were posted to the incorrect fund owner accounts, and a \$5.3 million transfer from investments to the checking account that was not recorded to the PERF account. We also found that a total of \$24 million of transfers from investments to the administrative checking account were incorrectly classified as investment expenses on the bank statements, bank summary spreadsheets, and in the PERF general ledger. When we identified the errors adjusting entries were made to the general ledger.

Errors identified in our prior report were not corrected by June 30, 2004. A \$3 million investment, transferred in to the commingled account in February 2003, was not yet recorded as owned by the PERF Fund. Amounts remained as owed between the bank accounts held for the Public Safety Officers' Death Benefit Fund and the State Employees' Death Benefit Funds as a result of having had their names reversed on the accounts in fiscal 2003.

Without timely corrections of errors or omissions, a change in investment income recognition between owner funds is necessary.

IC 5-10.3-3-7.1 states: "The board shall annually analyze for internal control purposes the fund's; (1) income and expenditures; (2) actuarial condition; (3) reserve accounts; (4) investments; and (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

MUTUAL FUND TAKEN OUT OF CRIF

For the period December 31, 2003, to June 24, 2004, an international mutual fund investment of \$264,170,952 was removed from the bank records for the portfolio holdings of the commingled retirement investment fund (CRIF) at PERF's direction. The CRIF is the commingled investments of all the pension funds, except for those PERF member investments that are directed outside of the guaranteed fund. The Legislators' Defined Contribution Plan members account balances directed to the consolidated fund option are also included in the CRIF. The December 15, 2003, direction letter from the executive director and the chief benefits officer specified that the investment account be transferred out of the CRIF and allocated to each fund proportionately to their total holdings in the CRIF, with the omission of the Legislators Defined Contribution account. In exchange, the funds receiving the international mutual fund holdings returned CRIF units held. At June 24, 2004, the bank records for the CRIF portfolio recorded a purchase of the mutual fund and reflected it again in the total CRIF value.

Minutes of the Board of Trustees meetings do not indicate that the board approved this or that it was discussed.

We were told that the investment was removed from the bank records for the CRIF because the international mutual fund investment did not provide daily valuations. The Legislators' Defined Contribution Fund was to have daily valuations that would be provided to the newly contracted service provider effective January 1, 2004. The CRIF is an investment option for the Legislators, and the international mutual fund comprised approximately 3% of the total CRIF value.

The funds have commingled ownership of the CRIF, and are accounted for by unit trust accounting. This is maintained on the official records of the custodian bank. During the six months that the investment was omitted from the CRIF portfolio, the CRIF and the unit values were undervalued by approximately 3%. In unit trust accounting, units are received by funds for deposits, and units are disbursed for withdrawals made. The balance of number of units held and the unit value determine the funds total investment value, and share

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

of the CRIF. As the unit values were understated, the number of units assigned to each funds' investment deposits and withdrawals for the period December 31, 2003, to June 24, 2004, was in error. We analyzed the effect to units assigned to each fund based upon monthly totals, and month end value understatements. We determined that the error caused a variance in both the total number of units held by each fund, and in the ownership share and total fund value. While at June 30, 2004, the investment was properly included in the bank records and total CRIF value, the number of units assigned to each fund for transactions during the six months of omission, remained in error on the official bank records.

The Legislators' Defined Contribution Plan consolidated fund option was understated for the six month period. We reviewed service provider reports of activity for the period January 1 to June 30, 2004, and identified the activity for the CRIF option. Four legislators received loans during the period when the values were incorrect, and eleven transferred funds out of the CRIF option. As the fund values were understated, the transactions were undervalued. This would result in lower eligible loan issuances, and lower investment earnings.

The Board of Trustees formally determines fund investments in accordance with IC 5-10.3-5-3(a). The Board provides in the approved investment policy guidelines that, "Staff duties are to administer the Fund in line with the policies and decisions of the Board and the provisions of governmental law and to provide input for the Board so that issues can be studied fully prior to any Board decision."

IC 5-14-1.5-4 requires board discussions and decisions to be evidenced in the minutes as required by IC 5-14-1.5-4.

MUTUAL FUND INVESTMENTS

We noted in our prior audit report (B22849) that board minutes from meetings of the PERF Board of Trustees did not indicate that the Board had approved or authorized the transfer of investments in exchange for mutual fund shares. There were four such transfers that totaled over two billion dollars and occurred from July thru October 2002. There also was no indication of approval of the reversal of two of the transfers, whereby in June 2003, stocks were transferred to PERF in exchange for the return of the mutual funds.

We found currently that on March 19, 2004, the Board of Trustees approved a motion "to ratify the staff's transfer of stock to mutual fund shares in 2002 and 2003 as outlined by the State Board of Accounts" in our prior report.

We also found that in July 2003, \$196 million of international investment holdings were transferred out in exchange for mutual fund shares. In March 2004, \$269 million of bond holdings were transferred out in exchange for mutual fund shares. Board minutes from meetings of the PERF Board of Trustees did not indicate that the Board had approved these transactions or other smaller holdings. We questioned these transactions and brought them to the attention of the PERF investment staff. The investment staff then reviewed the holdings and minutes and prepared a summary for the Board. On November 19, 2004, the Board voted to ratify the action of nine listed managers to invest all or part of the funds under their management in mutual funds or commingled funds.

The Board of Trustees formally determines fund investments in accordance with IC 5-10.3-5-3(a). The Board provides in the approved investment policy guidelines that, "Staff duties are to administer the Fund in line with the policies and decisions of the Board and the provisions of governmental law and to provide input for the Board so that issues can be studied fully prior to any Board decision."

IC 5-14-1.5-4 requires board discussions and decisions be evidenced in the minutes.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

FINANCIAL ACCOUNTING AND REPORTING

Prior Audit Report (B22849) - Fiscal 2003

In our prior five audit reports, we recommended that PERF establish reconciling and financial reporting schedules to help ensure procedures are performed in a timely manner so management and staff could detect any errors or differences timely. While some reconciling and financial reporting schedules have been developed, we found a lack of supervisory review and approval of financial accounting records and reconciliations that is also required to detect errors. Neither the journal vouchers, which contain the general ledger entries, or the trial balances, were signed and dated by managers, in order to indicate approval. We found instances of journal vouchers that omitted significant monthly entries and entries performed twice, that would likely have been detected by supervisory review. Journal vouchers were not assigned sequential unique numbers. In an effort to correct errors, journal vouchers and trial balances were reperformed. We observed duplicate versions of journal vouchers and trial balances. Error corrections are more appropriately handled by issuing another journal voucher evidencing the amount of the correction needed.

There were two sets of general ledgers maintained for the 1977 Police Officers' and Firefighters' Fund. One set was maintained with totals given a calendar year set of records, and the other on a fiscal year basis. These were not reconciled to each other. The calendar year basis is used by the actuary. The use of another set of records increases the risk of errors, which may be undetected. The use of another set of records for the 1977 Police Officers' and Firefighters' Fund was not formally authorized. The practice was discontinued effective December 31, 2003.

We also recommended in our prior five audit reports that procedures be documented in writing. This would help with consistency when there is a change in staff or staff responsibility. Procedures have not yet been documented in writing.

Fiscal 2004

During fiscal 2004, the reconcilements and financial reporting schedules had not been fully implemented and were not prepared in a timely manner. Our audit continued to find errors in amounts material to the funds that required adjustments. These may have been detected by managers had timely and complete reconciliations and analysis been performed.

Procedures had not been fully documented in writing by June 30, 2004.

Two CPA firms were engaged with respect to this finding, one to implement the reconciliation and financial reporting schedules, and another to recommend specific written internal control procedures. Additional accounting staff was also hired.

To address some of the above concerns, PERF began implementation of a new accounting software system for the general ledgers in February 2004, which replaced the manual ledgers maintained prior to that time. The system requires sequential series of journal vouchers and supervisory review prior to posting. Journal vouchers were made and input retroactive to July 2003 in order to have the entire fiscal period within the new system. This project was not completed until subsequent to the fiscal year end.

IC 5-10.3-3-7 requires that, "The board shall do all of the following . . . (5) Provide for the installation in the general office of a complete system of books, accounts including reserve accounts, and records in order to give effect to all the requirements of this article and to assure the proper operation of the fund."

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

LEGISLATORS' DEFINED CONTRIBUTION FUND NOT RECONCILED

Beginning January 1, 2004, the PERF Board implemented a pilot program for the Legislators' Defined Contribution Fund in accordance with public law. The PERF Board contracted with a service provider in order to implement daily investment selections. The contractor maintains detail accounts for each member and performs the necessary bank transactions associated with member options. At June 30, 2004, the bank balances exceeded the service provider's records of the member balances for two options, totaling \$172,000. The PERF Board had not obtained or required a reconciliation of the service provider's records to the associated bank records as of June 30, 2004.

The PERF Board also maintained a bank account for cash held by the Legislators' Defined Contribution Fund in excess of member balances. The balance at June 30, 2004, was \$415,788. It was largely owed to the PERF Fund for Legislators' Fund member loans issued from the PERF Fund's checking account for the past two fiscal years.

IC 2-3.5-5-2 (d) states that:

"Each participant shall be credited individually with:

- (1) the participant's contributions to the fund under section 4 of this chapter, which shall be credited to the participant's account;
- (2) the contributions made to the fund on behalf of the participant under section 5 of this chapter, which shall be credited to the participant's account;
- (3) the amount transferred to the fund under subsections (b) and (c), which shall be credited to the participant's account; and
- (4) the net earnings on the participant's accounts, determined under section 3 of this chapter."

Public law 126 – 2003 section 1 (d) (1) states that, "Notwithstanding IC 2-3.5-5-3(b)(2), the PERF board shall implement a member's selection under IC 2-3.5-5-3 not later than the next business day following receipt of the member's selection by the PERF board. This date is the effective date of the member's selection." Section 1(d)(2) states that, "Notwithstanding IC 2-3.5-5-3(b)(7), all contributions to a members' account in the fund must be allocated under IC 2-3.5-5-3 not later than the last day of the quarter in which the contributions are received and reconciled in accordance with the member's most recent effective direction."

Each agency is responsible for maintaining an effective and accurate accounting system for subsidiary and supplementary records. At all times, the agency's manual and computerized records, subsidiary ledgers, control ledger, and reconciled bank or auditor's balance should agree.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

BENEFIT EXPENSE

Prior Audit Report (B22849) - Fiscal 2003

PERF did not detect a material error in the benefit expense recorded for the PERF Fund. During the fiscal year, benefits expense was overstated for the PERF Fund by \$38,150,818. The check register reports for benefits listed two subtotals for the PERF Fund. The last line on the check register reports was incorrectly labeled as "Subtotal for PERF," when it was actually the grand total for the entire report, including all checks issued from all funds administered by PERF. This final "subtotal" was used as the total for the PERF Fund benefit expense, and was also used in determining the checking account deposits each month. When we brought this to their attention, the benefit expense errors were corrected.

Fiscal 2004

The system continued to issue the reports that labeled the grand total as a PERF Fund total. We were told the check register reports were corrected in July 2004.

Another error in check registers was found in our testing of rollovers issued. We found that non-taxable rollovers for PERF were listed on the check registers with a dollar amount of zero. We reviewed each page of rollover check runs for the fiscal year and identified that this occurred from October to December 2003. We obtained copies of the cancelled checks and compiled them. PERF then compared to their accounting entries and identified a necessary adjustment of \$115,000.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of managements' objectives, and compliance with laws and regulations. Among other things safeguarding controls over cash and all other assets, and forms of information processing are part of an internal control system.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures.

TAX WITHHOLDING REMITTANCE ERRORS

Prior Audit Report (B22849) - Fiscal 2003

PERF does not maintain withholdings control accounts. A control account would include entries to compile total taxes owed and would reflect payments issued.

During fiscal 2003, errors occurred in remitting tax withholdings in an accurate and timely manner. Tax withholdings were not remitted in August 2002 and thereafter were remitted one month late until November 2002. For the period August through December 2002, tax withholdings for manual checks issued were not remitted. For the period January to June 2003, PERF could not provide detail calculations or support for the withholdings remitted. PERF also could not locate or provide a comparison of the 2002 taxes remitted to the total as reported on the 1099 reports issued.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

The Internal Revenue Service assessed penalties for 2002 and 2003 for four funds that PERF administers. A penalty of \$485.73 for the Judges' Retirement Fund was paid.

At our request, for each fund administered, PERF itemized and identified the federal and state taxes withheld from each system check register and manual check issued for the period July 1, 2002, to June 30, 2003. PERF compared this to the withholdings remitted. Variances existed for both federal and state withholdings for six of the seven pension funds administered. The net effect was that two funds had net total underpayments and four funds had net total overpayments. The net differences ranges from \$54,840 underpaid for the 1977 Police and Firefighters' Fund to \$2,291,147 overpaid for the PERF Fund.

Fiscal 2004

PERF implemented withholdings control accounts in conjunction with the new accounting software for fiscal 2004. Adjustments were made to recognize the prior year tax calculation, except for that of the amount owed for the 1977 Police Officers and Firefighters' Fund. For fiscal 2003, the net total recognized as overpaid for federal withholding was \$1,945,137 and the overpaid state withholding in 2003 were \$333,075. During fiscal 2004, PERF overpaid a net total of \$466,413 in state withholding taxes. At June 30, 2004, PERF had not received any refunds of the overpayments.

We reviewed IRS account history through March 15, 2005, for the PERF Fund for calendar 2002 and 2003 withholdings. The IRS assessed additional taxes and penalties to these accounts beginning June 30, 2003. We were told by PERF that this was the result of the IRS records of the totals reported on form 1099s issued. As of March 2005, PERF has paid total penalties of \$183,817, and additional assessments of past taxes of \$ 539,633. Additional assessments and penalties were also paid that totaled \$1,108,133 for which PERF was able to obtain IRS abatements and refunds.

PERF has not identified the variance between the calculations of overpaid federal tax withholdings remitted and the IRS account activity.

Every governmental unit is required to comply with all filing requirements of federal and state agencies.

Officials and employees have the duty to pay claims, remit taxes, etc., in a timely fashion. Any penalties, interest or other charges paid by the governmental unit may be the obligation of the responsible official or employee.

ACCOUNTING FOR VOID CHECKS

We stated in our prior audit report (B22849) that PERF did not have procedures in place to account for voided check transactions since at least July 1, 2001.

The computer system used by PERF provides for check status changes to be recorded, one of which is to void the check. We found that except for the 1977 Fund, there were no accounting entries made to account for voided checks. The general ledger accountants were unaware of the existence of SIRIS reports that identify the voided checks. There also were no procedures in place to review and approve the void check transactions, or to account for the withholding taxes associated to these voided checks.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

During the current audit period PERF obtained reports of the voided check transactions for the prior years as well as for fiscal 2004. These were recorded on the general ledgers effective June 2004. However, PERF is still in the process of developing procedures for voided checks, the reconciliation of voided checks, and revising internal controls.

Each agency is responsible for maintaining an effective and accurate accounting system for subsidiary and supplementary records. At all times, the agency's manual and computerized records, subsidiary ledgers, control ledger, and reconciled bank or auditor's balance should agree. If reconciled bank or auditor's balance is less than the subsidiary or control ledgers, then the responsible official or employee may be held personally responsible for the amount needed to balance.

CHECK ISSUANCE PROCEDURES

As stated in our prior audit report (B22849), PERF uses an outside service to print the checks it issues. Prior to sending the check print file to the printer, at least two accounting staff and other computer contract staff have access to update the file. This could result in unauthorized changes to the checks printed, that would not otherwise be reflected in PERF's records. PERF staff should not have access to the check print file. Update access to the check print file should be restricted to the SIRIS process user ID that creates the file.

Staff retained access to the check print file during fiscal 2004. PERF indicated that restricted access would be implemented in early 2005.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of managements' objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets, and forms of information processing are part of an internal control system.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making.

LACK OF CONTROLS - MANUAL CHECKS

Prior Audit Report (B22849) - Fiscal 2003

Manual checks are those checks printed or typed independently from the computer system. PERF must use manual checks to issue replacement checks as the system does not have this function. Also, manual checks have to be issued to pay some benefits for system transactions that have failed. The system is limited to printing benefit checks once a month. A policy was put in place to issue manual checks for all first benefits, or refunds that were not processed within one month, or that indicated an immediate need. The number of manual checks issued in fiscal 2003 was an increase of 300% over the total issued in fiscal 2001, and 84% more than was issued during fiscal 2002. Check amounts also increased and were observed as issued up to \$125,000, as a first month benefit payment regularly includes the entire balance of the savings account.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

The manual check recording process consists of procedures with multiple points of repetitive entry without review to ensure accuracy, propriety, or subsequent system entry. Manual checks were largely printed using a software package. A detail spreadsheet is maintained which indicates whether checks are replacements or original; however, it only lists the net check amount. Photocopies of the check stubs for manual checks issued are made and transmitted to the accountant in order to effect general ledger recognition and checking account deposits. The check stubs do not identify the issuing fund, or whether the payment was for a benefit or refund. Our analysis indicates that approximately \$1.1 million issued for refund checks was misclassified as benefits expense. Misclassification of these expenses affect the reserve to which it belongs, either members reserve or the benefits in force reserve. In this case, the benefits in force reserve were incorrectly charged.

We identified benefits expense overstatements totaling \$2,041,586. These were caused by submitting duplicate and triplicate photocopies of manual check stubs for the accountant to add and recognize as original issue checks. Also, it includes an error of recognizing a SIRIS check register that was not actually printed, and also recognizing the expense for the replacement checks issued. Other math errors were also found in the calculator tapes that evidence the compilations of the original issue manual checks. PERF corrected the errors when it was brought to their attention.

We also found instances where: the input into SIRIS did not agree to the software records that printed the checks; records could not be located to support the checks issued; and checks that were recorded as voided were cashed.

Other internal control weaknesses related to manual checks include:

- (1) Insufficient segregation of duties as the same person is involved with issuing, recording and mailing checks.
- (2) Insufficient segregation of duties as those who order the manual checks to be issued retain any supporting documents without review by the disbursement accountant.
- (3) No process for verifying that replacement checks are properly classified in the manual check register. Manual check requests are not filed in numerical order in a single location.
- (4) Checks submitted for the general ledger entries were not compared to the spreadsheet or to subsequent SIRIS entries.
- (5) There was no record maintained to indicate which manual checks had been posted to SIRIS.
- (6) SIRIS records the manual checks as issued when entered onto the system, not when they were actually issued on a prior date. This could affect tax reporting years.
- (7) The bank reconciliation process only accounts for those manual checks entered onto SIRIS. There is no outstanding check list maintained for manual checks not yet entered into SIRIS. As of August 2003, over \$2 million dollars of manual checks issued during fiscal 2003 had not been entered into SIRIS.
- (8) There was insufficient security during fiscal 2003 regarding the unused check stock.
- (9) Tax withholdings for original issue checks were not remitted or accounted for in a timely manner.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

Fiscal 2004

The system continued to have an inability to issue replacement checks. Manual checks remain required to be issued for some benefit transaction types that have failed on the SIRIS. In October 2003, the system was modified in order to allow PERF to issue refunds and benefit rollovers at least weekly. Thereafter, the quantity of manual checks and dollar amounts issued decreased.

Procedures to record manual checks were modified as of October 2003 to include listing all check information, such as fund, gross check amount and withholdings detail. In conjunction with the cash reconciliation project a CPA firm compiled the expense entries and agreed them to the source detail, including the manual check listing.

PERF reported to us that improved internal control procedures for manual checks were developed and fully implemented by October 30, 2004.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

INTERNAL CONTROL OVER CONTRIBUTION REVENUE COLLECTIONS

Prior Audit Report (B22849) - Fiscal 2003

Our testing of contribution revenue collections revealed the following deficiencies in the internal control structure:

- (1) Duties were not sufficiently segregated in the processing of manual contribution payments. The same employee prepared the deposit, posted SIRIS, and posted the cash receipts ledger.
- (2) Collections received without proper accompanying paperwork were not adequately safeguarded prior to being deposited.
- (3) Temporary member accounts are set up for contributions received without accompanying member records. These accounts are changed to permanent when proper member record information is received. There is no check performed to determine the status of temporary member accounts on the system to detect errors or misuse of those accounts. A contract was in place for a vendor to research and resolve temporary accounts; however, it was cancelled in March 2003, due to the vendor wanting to shift the work out of state.

Fiscal 2004

The prior report findings were detected during fiscal 2004 and were also conditions of fiscal 2004. However, we noted that inactive temporary member accounts were frozen beginning in September 2003. An account that is frozen on the system cannot have transactions recorded until the account is unfrozen by authorized staff. The freezing of member accounts is planned to be performed quarterly. Additionally, PERF indicated that proper segregation of duties and safeguarding of collections began after our audit period.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

1977 POLICE AND FIRE FUND CONTRIBUTIONS

Prior Audit Report (B22849) - Fiscal 2003

The 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund) receives employer and employee contributions at the rate of 21% and 6%, respectively, of the salary of a first class officer or firefighter. PERF does not ensure that employer and employee contributions are recorded in the correct proportion to each other in the financial statement accounts or identify reasons for differences. This is a lack of internal control over the recording of employer and employee contributions in financial statement accounts.

In our review of 1977 Fund contributions, we determined that total employee contributions recorded on the general ledger were significantly more than the correct proportion of total contributions. For fiscal year 2003, total employee contributions recorded for the 1977 Fund are estimated to be \$2,029,000 more than they proportionately should be. This indicates errors were made in classifying receipts between employer and employee contributions.

Fiscal 2004

The CPA firm hired for the reconciliation project identified errors in recording contributions. For fiscal 2004, they identified \$491,673 in employer contributions that were recorded as employee contributions of the 1977 Fund. We reviewed and traced an error which occurred on August 1, 2003, for \$475,560. One batch was listed with employer and employee totals reversed on a spreadsheet used to compile the total report of collection. Review of the spreadsheet would have detected the error as the employee contributions at 6% should never exceed the employer contributions that are paid at 21%. There is no indication that the spreadsheet was reviewed or approved by PERF supervisors.

In their response to the prior report, PERF that purchases of prior service credit are not separately classified from regular contributions. The CPA firm review indicated that the prior service credit payments are not recorded in the SIRIS. It is unclear as to whether these payments should be entered into SIRIS, or whether they are refundable, particularly if paid on behalf of an employee.

PERF reported that internal controls had been developed and implemented as of February 2005 with the assistance of another CPA firm.

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

JUDGES CONTRIBUTIONS

Judges have six percent of their salary withheld in accordance with IC 33-38-7-10(e) in order to participate in the Judges' Retirement Fund. Creditable years of service for Judges are maintained in PERF's SIRIS computer system. No amounts are to be paid by the Judges beyond twenty-two years. SIRIS issues a message indicating that a judge has reached twenty-two years of service, and will not post any further member contributions. If contributions mistakenly continue, SIRIS automatically posts these to the employers' account.

We found that there were seven judges who reached twenty-two years of service between January 1, 2003, and March 6, 2004, and continued paying contributions. However, PERF did not contact the payer agencies about the continued contributions in a timely manner or arrange refunds of the overpayments in a timely manner. The total overpaid during 2003 and 2004 was \$19,645.

Per IC 33-38-7-10(f): "The auditor of state and the county auditor shall pay and credit to the fund the amounts described in subsection (e) as provided in IC 33-38-6-21 and IC 33-38-6-22. However, no amounts shall be paid on behalf of a participant for more than twenty-two (22) years."

IC 33-38-6-13 requires the following, in part: "(1) the board shall distribute the corpus and income of the fund to participants and their beneficiaries in accordance with this chapter, IC 33-38-7, and IC 33-38-8. (2) A part of the corpus or income of the fund may not be used or diverted to a purpose other than the exclusive benefit of the participants and their beneficiaries."

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of managements' objectives, and compliance with laws and regulations. Among other things, safeguarding controls over cash and all other assets, and forms of information processing are part of an internal control system.

LACK OF BENEFIT TRANSACTION ACCOUNTING

Prior Audit Year Report (B22849) - Fiscal 2003

There was no definitive population data for new benefits; benefit adjustments; or benefit deletion transactions. The expected benefit payroll is not tracked or monitored by either number of expected checks to be issued or dollar amount authorized. These were designed to be provided in a Monthly Payroll Summary Report with further itemized detail provided in monthly reports entitled: New Retiree Detail, Monthly Benefit Adjustment Detail, Reinstated Retiree Detail, and Retirees Suspended/Terminated Detail. The reports are not functioning as designed. The transaction detail provided did not support the change in the monthly benefit payroll issued. Also, we found new retirements that were not reported.

Transaction information should be provided to managers for monitoring purposes. For the PERF Fund, pension administrators identify new retirements from a spreadsheet prepared internally to track files processed. There is no such listing prepared for the other funds administered by PERF.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

Fiscal 2004

The system error continued during fiscal 2004. PERF did not have procedures in place to ensure the benefits paid are valid and authorized. The expected benefit payroll is not tracked or monitored by either number of expected checks to be issued or dollar amount authorized.

The computerized accounting system must maintain electronic audit trails sufficient to trace all transactions from original source of entry into the system, through all system processing, and to the results produced by the system. The audit trails must also maintain sufficient information to trace all transactions from the final results produced by the system, through all system processing, and to the original source of entry into the system. These audit trails must be protected from modification and deletion.

The computerized accounting system must incorporate features that assure all accounting information is reported accurately and completely. Output reports must have appropriate subtotals to allow reconciliation of reports within the system and reconciliation to external documentation.

BENEFIT AND REFUND SYSTEM CONTROL WEAKNESSES

As stated in our prior report (B22849), the processing of benefits and refunds occurs thru the computer system, which maintains the subsidiary accounts for the members and employers reserves. Control weaknesses over the processing of benefits and refund transactions in SIRIS included the following design weakness conditions:

PERF had certain system controls disabled such that disbursements against a member's annuity account may exceed the balance in the account. Additional monitoring was not implemented.

The segregation of duties that PERF may accomplish is limited by incompatible functions that exist within system defined roles that allows users to approve their own work. There also is no inquiry only capability, such that access to process transactions are given to those whose duties are to only observe transactions.

The system design was insufficient in order to ensure that benefits and refunds were calculated and paid accurately in an efficient, timely manner with respect to the processing of the final contributions. (Also see "Final Annuity Savings Account Contributions Not Paid," pages 23 and 24)

SIRIS design omits a transaction to record final service credit. Service credit is regularly recorded in quarter year increments upon posting quarterly contributions. Upon retirement, the exact service credit must be calculated and compared to the system total. In order to post the exact service credit total, PERF staff must now access and delete contribution entries and re-enter them with the same contributions with the service credit changed. This design has required an additional level of review for this specific transaction to ensure the contributions are re-entered correctly. However, we observed that contributions were re-entered as received in prior years.

During fiscal 2004, we additionally found that the majority of SIRIS entries to deduct members' balances at retirement did not agree to the checks issued, if withdrawn, or to the amount annuitized. The association of the entry to the source transaction is required for an accurate accounting.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

SIRIS operation weaknesses that pertain to the processing of benefits and refunds included the following:

- (1) Inadequate segregation of duties. Staff was generally assigned too much access. Combined role assignments give many users the ability to audit their own work or to perform incompatible functions within SIRIS.
- (2) SIRIS maintains check records for disbursement transactions that have been entered, but not yet authorized. As of September 26, 2003, a total of over \$7 million remained in the entered status for 230 checks dated from April 2002 through June 2003. There were no procedures in place to research and resolve these transactions. Those which we observed should be deleted, as their issuance would result in a duplicate payment.
- (3) Lack of monitoring of completed transactions to ensure both system and manual procedures were accurate and correctly applied.

In response to our prior report, PERF hired a CPA firm to review internal controls including the roles within SIRIS as well as manual processes, and develop specific recommendations. The firm was also hired to monitor completed transactions and this remains an ongoing project.

PERF accounting staff reviewed and deleted those checks we identified in fiscal 2003, as having an entered status, which if authorized could result in a duplicate payment. PERF identified additional procedures to detect and correct these in the course of business. However, the procedures did not include obtaining a list of checks in entered status.

The computerized accounting system must provide input edits and controls to assure that information entered into the system is accurate, that all appropriate information is entered into the system, that information is entered into the system only once, and that all information entered into the system is authorized by management.

Written procedures must be available for all computerized accounting systems which provide instructions on the requirements for the approval of information prior to entry into the computer, as well as the accurate entry, processing, and reporting of information from the accounting system.

OVERPAYMENT OF BENEFITS - EARLY RETIREMENT FACTOR

Five percent (3 of 60) of the PERF Fund new retirees tested were paid full retirement benefits when they had retired under the provisions of a reduced early retirement. The SIRIS system did not use the early retirement factor in calculating the pension of these members who were required to receive a reduced pension under the provisions of early retirement. The amount of overpayment for the three retirees is \$3,061.93 annually. PERF should seek reimbursement for these overpayments.

IC 5-10.2-4-1 (c) states: "A member who has reached age fifty (50) and has at least fifteen (15) years of creditable service is eligible for early retirement with a reduced pension." The reduced pension calculation is specified at IC 5-10.2-4-5.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

UNDERPAYMENT OF STATE EMPLOYEE DISABILITY BENEFITS

Prior Audit Report (B22849) - Fiscal 2003

State employees who become disabled may begin to receive their PERF disability retirement while also receiving the state long term disability benefit. Additional state service is earned while on the long term disability plan. The state disability plan administrator reports to PERF when the state disability benefit term is completed, which cannot exceed a four year term. The PERF pension benefit should then be increased by recognizing the total state service credit.

Since May 2002, PERF has not recomputed any state employee disability retiree pensions after the completion of their coverage under the long term disability plan, unless the member contacted PERF to complain. A state employee disability retiree that had completed their long term disability plan was found in our testing to be underpaid by \$2,552.52 annually.

Fiscal 2004

The error continued during fiscal 2004. PERF hired a CPA firm to recalculate these pensions and ready them to be set up in SIRIS so that the retirees can be paid correctly. PERF is still in process in correcting these errors.

IC 5-10.2-3-1(f) states: "A member who is a state employee is entitled to service credit for the time the member is receiving disability benefits under a disability plan established under IC 5-10-8-7."

FINAL ANNUITY SAVINGS ACCOUNT CONTRIBUTIONS NOT PAID

Prior Audit Report (B22849) - Fiscal 2003

Member contributions are remitted on a quarterly basis by their employers as required by IC 5-10.3-7-12.5. Members regularly retire or request refunds prior to PERF's receipt of their final contributions. If final contributions to members' accounts are received and posted subsequent to the retirement or refund transaction entry on PERF's computer system, the contributions will remain in the employee member's account. This also occurred for account refunds processed for the non-PERF Funds.

Twenty percent (22 of 108) of member retirements and refunds that we tested for the fiscal year ended June 30, 2003, did not receive their final contributions that were posted to their account. The total unpaid to those members was \$8,084.71.

We also found three instances of PERF retirees', whose final contributions from 2002 were not recorded to their accounts, and as such they did not receive payment. The total unpaid to those members was \$759.58.

Fiscal 2004

Sixty-four percent (36 of 56) of PERF retirements that we tested for the fiscal year ended June 30, 2004, were found to have account balances remaining in the members' account. We found that SIRIS entries to remove the account balances as paid or annuitized largely did not agree to the checks issued or annuity calculations. The balances of the thirty-six retiree accounts totaled \$ 11,966. Of this, \$ 1,728 was found to be owed to retirees. Only three of the thirty-six retirees were owed the entire balance recorded. Seven were

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

owed only part of the balance, as checks issued exceeded the amount deducted from the account. Twenty of the balances held were not owed as they had been paid in full as withdrawals or in the amount annuitized. Six retirees had received an amount annuitized that exceeded the balance remaining in their account by \$1,957. Of these, five excess annuities were caused by use of employer reported final contributions totaling \$448 that were never recorded on SIRIS. For another, PERF had omitted the cumulative investment losses posted to the account of \$1,509.

IC 5-10.2-2-1.5 requires that:

- "(1) Each board shall distribute the corpus and income of the fund to members and their beneficiaries in accordance with the retirement fund law.
- (2) No part of the corpus or income of a fund may be used for or diverted to any purpose other than the exclusive benefit of the members and their beneficiaries."

PERF Fund retirees are entitled to the entire amount credited to the member in their Annuity Savings Account under various payment options in accordance with IC 5-10.2-4-2. "After a member suspends his membership, he is entitled to withdraw in a lump sum the amount of his contributions plus interest credited to him." (IC 5-10.2-3-6)

IC 5-10.3-3-7 states, in part: "the Board of Trustees shall . . . 5) Provide for the installation in the general office of a complete system of books, accounts including reserve accounts, and records in order to give effect to all the requirements of this article and to assure the proper operation of the fund."

FINAL QUARTER INTEREST NOT PAID

Prior Audit Report (B22849) - Fiscal 2003

PERF posts interest to member accounts at the end of each calendar quarter. A PERF Fund member's final quarter interest earned on their annuity savings account is to be included in the amount annuitized or paid to the retiree.

Due to the timing of retirement transactions, we found that certain retirements processed were omitted from the quarterly interest posting. In our review of the PERF Fund, we found that when the retirement is authorized by PERF at the end of a quarter, but paid the first month of the next quarter, the last quarters' interest was not posted to their account, and therefore, was not included in the amount paid to the member.

In our testing of PERF retirees that rolled their Annuity Savings Accounts to a qualified plan, we found three of twenty-seven that did not receive all the interest earned in their account for the last quarter before their effective retirement date. Total interest owed to these three retirees is calculated at \$1,889.37.

Fiscal 2004

PERF has not corrected this in their system. We tested ten final interest calculations for PERF retirees processed in fiscal 2004. We found two that did not receive all the interest earned in their account for the last quarter before their effective retirement date. Total interest owed to these two retirees is calculated at \$563.66.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

" . . . When a member who participates in the guaranteed program retires, becomes disabled, dies, or suspends membership and withdraws from the fund, the amount credited to the member shall be computed without regard to market value and is based on the balance of the member's account in the guaranteed program as of the last day of the quarter preceding the member's distribution or annuitization at retirement, disability, death, or suspension and withdrawal, plus any contributions received since that date plus interest since that date." (IC 5-10.2-2-3 (g)).

" . . . When a member who participates in an alternative investment program retires, becomes disabled, dies, or suspends membership and withdraws from the fund, the amount credited to the member shall be the market value of the member's investment as of the last day of the quarter preceding the member's distribution or annuitization at retirement, disability, death, or suspension and withdrawal, plus contributions received after that date." (IC 5-10.2-2-3 (f)).

INCORRECT MONTHLY BENEFITS

As stated in our prior audit report (B22849) in the finding entitled Incorrect PERF Benefits, nineteen percent (10 of 53) of the PERF Fund new retirees tested were paid an incorrect monthly benefit. The errors in benefit calculations resulted in five retirees being underpaid a total of \$988.44 annually, and five being overpaid a total of \$345.48 annually. These errors appeared to be due to errors in manual calculations or data entry.

Currently we found fifteen percent (9 of 60) of the PERF Fund new retirees tested were paid an incorrect monthly benefit. The errors in benefit calculations resulted in two retirees being overpaid a total of \$2,440.43 annually, and seven being underpaid a total of \$605.61 annually. The overpayments were caused by manual data entry errors of overstating wages and entering an incorrect option. The seven underpayments were caused by understated service credit and highest five year average wages. Some of the understated wages were caused by use of the preliminary employer reports, for which later correcting reports were submitted but not used to recalculate benefits.

One of four Excise Police and Conservation Officers' new retirees tested was underpaid \$65 annually. This was caused by use of understated final wages in the high five salary calculation.

PERF identified a project and hired a CPA firm to recalculate all PERF benefits that were initiated after the SIRIS implementation in April 2002. The project remains in progress.

PERF Fund retirees are entitled to the properly calculated monthly pension benefit under the various payment options in accordance with IC 5-10.2-4-4, IC 5-10.2-4-5, and IC 5-10.2-4-7. PERF Fund retirees are also entitled to the properly calculated monthly annuity benefit under the various payment options in accordance with IC 5-10.2-4-2.

RETROACTIVE PERF DISABILITY BENEFITS

PERF Fund member disability pensions are calculated back to the effective disability onset date. If there were cost of living adjustment (COLA) pension increases during the period from the effective disability date to the date that the pension is determined, these increases are included in the current pension benefit base amount.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

In our prior audit report (B22849), we determined that disability pensions were calculated without including COLA pension increases that occurred between the effective disability date to the date that the pension benefit amount was determined. We also found instances where the initial retroactive benefit was calculated incorrectly.

Currently, we found that PERF hired a CPA firm to review and correct any incorrect disability payments back to April 2002 when the SIRIS retirement calculations began. The project remains in progress. In addition, accounting staff received additional training and information necessary to calculate the retroactive PERF disability benefits correctly.

PERF Fund retirees are entitled to the properly calculated monthly pension benefit under the various payment options in accordance with IC 5-10.2-4-4, IC 5-10.2-4-5, and IC 5-10.2-4-7.

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

INCORRECT REFUNDS - DEATH IN SERVICE

Prior Audit Report (B22849) - Fiscal 2003

Member account refund amounts are calculated and determined by PERF's computer system, based on the data and parameters established in the system. Refunds of member accounts to death in service beneficiaries were not being processed correctly by PERF's computer system. Refund transactions recorded on member accounts did not match the check amounts paid. These were found to have occurred for both the PERF Fund and the 1977 Police Officers' and Firefighters' Pension Fund.

In our testing of refunds of member accounts, we found five of five death in service refunds were paid an incorrect amount. Three of these had final contribution and/or interest amounts that were coded on PERF's computer system as removed from the member's account, but were not actually paid to the member's beneficiary. The fourth item had two beneficiaries, one of whom was paid half the remaining account balance, and the other was paid the entire account balance. The fifth item had the final contributions refunded twice but omitted the final interest.

Fiscal 2004

PERF identified projects to ensure SIRIS records death refund transactions to match the check amounts paid and has a CPA firm validating prior transactions and proposing error resolutions. PERF lists these projects as remaining in progress.

PERF Fund members are entitled to the entire amount credited to their Annuity Savings Account in accordance with IC 5-10.2-4-2, IC 5-10.2-3-6, and IC 5-10.2-3-7.5(e).

1977 Police and Fire Fund members are entitled to the entire amount credited to their member account in accordance with IC 36-8-8-8, IC 36-8-8-16, and 35 IAC 2-2-1.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

UNPAID RETROACTIVE BENEFIT

For new retirees, a retroactive payment is made for all benefits owed from the effective retirement date to the payment date. This retroactive payment is to include all prior monthly benefits, plus the additional thirteenth check pension benefit amounts since the effective retirement date. This would primarily occur for disability benefits. The thirteenth check represents additional benefits paid, as authorized by the legislature, which do not increase the base pension.

As stated in our prior audit report (B22849), we found that the computer coding to increase benefit checks for the retroactive thirteenth check pension benefit, also correspondingly deducts it from the check. Therefore, the increase was not paid to those receiving the retroactive adjustment.

The prior report findings were detected during fiscal 2004 and were also conditions of fiscal 2004. PERF has not corrected this in their system.

IC 5-10.2-2-1.5 states, in part:

- "(1) Each board shall distribute the corpus and income of the fund to members and their beneficiaries in accordance with the retirement fund law.
- (2) No part of the corpus or income of a fund may be used for or diverted to any purpose other than the exclusive benefit of the members and their beneficiaries."

EMPLOYER RESERVE CHARGES

Prior Audit Report (B22849) - Fiscal 2003

Employer reserve charges are the actuarial costs to the employer for the funding of the member's pension at retirement. In our testing of employer reserve charge amounts we found the following errors:

- (1) The 1977 Police Officers' and Firefighters' Fund incorrectly uses the PERF Fund Employer Reserve Charge table instead of the 1977 Fund Employer Reserve Charge table established by PERF's actuary. This varies significantly from the table used for the PERF Fund.
- (2) The actuarial cost tables have not been updated to that currently approved by PERF's actuary which incorporates different interest rate and mortality assumptions. This occurred for the Judges', Legislators', and Prosecuting Attorneys' Retirement Funds.
- (3) In our testing of PERF retirements, four of fifty three tested had an incorrect employer reserve charge calculated. Two employers were overcharged a total of \$81,597. The other two employers were undercharged a total of \$1,982.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

- (4) The actuarial tables have retiree only, joint (spouse), and survivor factor columns for calculating the cost of benefits. These factors were found to be incorrectly applied for the benefit cost of all Prosecuting Attorneys' and Legislators' Fund new retirees tested, and for nine of ten Judges' Fund retirees tested.
- (5) Employer reserve charges were incorrect for all three 1977 Fund death in service benefits tested. In one case the benefits were under funded by 27%, or \$59,000. The other two cases were over funded by 32%, or \$49,000 and 78%, or \$307,000, respectively.

Fiscal 2004

Throughout fiscal 2004, the employer reserve charges continued to use the incorrect actuary tables as detailed in items one and two above. We additionally found that the PERF actuarial cost table was used for the Excise and Conservation Officers' Retirement Fund, which has differences in statutory benefit provisions.

In our testing of the fiscal 2004 PERF retirements, six of sixty tested had an incorrect employer reserve charge calculated. Four employers were overcharged a total of \$13,946. The other two employers were undercharged a total of \$2,056.

We also found inaccurate PERF employer reserve charges that were recorded during fiscal 2004 for material amounts. See also the finding "Reserve Reconcilements."

The actuarial tables in place continued to be incorrectly applied as stated in item 4 above for the Judges', Legislators', and Prosecuting Attorneys' Funds.

Employer reserve charges remained incorrect for the 1977 Fund death in service benefit. A death benefit tested was under funded by 39%, or \$99,000.

On November 19, 2004, the PERF Board of Trustees formally adopted actuarial reserve factors for all of the defined benefit plans administered. These were adopted to reflect the current mortality and interest rates used in the preparation of annual actuarial evaluations.

The actuary tables that were adopted by the Board of Trustees in accordance with IC 5-10.3-3-7(7) should be accurately applied.

INTEREST CREDIT TO 1977 FUND MEMBERS

The annual 5.5% interest for the 1977 Police Officers' and Firefighters' Fund has been based on a calendar year basis. The calendar year interest is usually recorded in late March subsequent to posting all contributions received for the quarter ended December 31. We found that there was no annual interest posted to the members' accounts during the fiscal year ended June 30, 2004. Instead, the total interest of \$16,203,362 for calendar year 2003 was posted to members accounts in August 2004. The contributions were not posted in a timely manner and as such the interest crediting was delayed. Further, we found that the interest crediting has not been transitioned from a calendar year basis to a fiscal year basis as required by 35 IAC 2-2-2.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

In addition, we found an overpayment of interim interest from a 1977 Fund member's account. In February 2004, interest of \$1,530.83 was calculated and refunded to the member. The calculation should have been \$5.85. The excess interest paid of \$1,524.98, less contributions that were not refunded and remained on the member's account of \$287.47, gave the net total overpaid of \$1,237.51. PERF should pursue action to obtain repayment. The incorrect calculation of interim interest earnings appears to be system generated, and as such, there may be further refunds that included overstated interim interest.

35 IAC 2-2-2 states that when crediting interest on employee contribution accounts of the 1977 Police Officers' and Firefighters' Fund:

"the State Board shall:

- (1) Credit interest on the prior fiscal year-end balance.
- (2) Cease crediting interest to accounts which have no activity after five (5) years after the last contribution posting, and, which have total service credit of less than twenty (20) years.
- (3) Not credit interest at a rate greater than the investment income earned." [35 IAC 2-2-2]

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of managements' objectives, and compliance with laws and regulations. Among other things, safeguarding controls over cash and all other assets, and forms of information processing are part of an internal control system.

PROSECUTING ATTORNEYS' DISABILITY RETIREMENT

Our test of Prosecuting Attorneys' retirements processed in fiscal 2004 found that a disabiltant was overpaid \$1,038 annually. In calculating the benefit, PERF applied the statutory provision of a regular retirement. For a regular retirement under this fund, the highest salary is used; whereas for a disability, the current salary is applied. In this case, the current salary reported was less. PERF should seek reimbursement for the overpayment.

IC 33-39-7-18 specifies the computation of the disability benefits for the Prosecuting Attorneys' Retirement Fund is based on: ". . . the amount of the annual benefit payable to a participant who meets the requirements for disability benefits under section 17 of this chapter is equal to the product of (1) the annual salary that was paid to the participant at the time of separation from service; multiplied by (2) the percentage prescribed in . . ." the Indiana Code.

PUBLIC EMPLOYEES' RETIREMENT FUND
BOARD OF TRUSTEES
EXIT CONFERENCE

The contents of this report were discussed on April 20, 2005, with Mr. David Adams, Executive Director; Mr. Bruce Kimery, Deputy Director; and by e-mail with Mr. Craig Hartzer, former Executive Director. The official response has been made a part of this report and is on pages 31 through 33. Mr. Craig Hartzer's response is on pages 34 and 35.



OFFICIAL RESPONSE

143 WEST MARKET STREET
INDIANAPOLIS, IN 46204
TEL (317) 233-4162
TOLL FREE (888) 526-1687

WWW.PERF.IN.GOV

State Board of Accounts
Indiana State Board of Accounts
302 West Washington Street
Room E418
Indianapolis, Indiana 46204

Ladies and Gentlemen:

This letter serves as our response to the State Board of Accounts Audit Results and Comments for the Public Employees Retirement Fund (PERF) dated June 30, 2004. The results of this audit were presented to PERF on April 20, 2005. As the new Executive Director of PERF, I greatly appreciate your comments which have provided me with valuable insight into some of the issues that are impacting PERF. Even though I have only been here since March 8, 2005, having your insight and guidance provides me the opportunity to determine our plans for permanently resolving these issues.

As noted, there are thirty (30) audit findings for the fiscal year that ended on June 30, 2004. This is an increase of seven (7) audit findings over the previous year. Twenty-three (23) of the audit findings in June 30, 2004 are the same as previously documented in the June 30, 2003 audit. For each of 23 findings, the State Board of Accounts has provided an update of the activity in Fiscal Year 2004.

The 30 findings were categorized by the State Board of Accounts under the following business processes and control areas:

- Internal control weaknesses that the auditor considered represented a risk of undetected errors, misstatements or irregularities that can be significant to the funds affected
- Transactions that the auditor considered irregular, unsubstantiated or without written evidence of authorization



- Control weaknesses which the auditor considered represented a noncompliance to legal requirements or retention of funds
- Calculations of retirement benefits or refunds that the auditor reported as inaccurate or uncorrected due to human or system error
- Inaccurate calculations of Benefits in Force (BIF) requirements that provide detail of transfers required between the employer reserve and BIF

Each of these findings represents issues with the internal control structure and environment. Internal controls and environment are broadly broken down into people, process and technology. From my perspective, continuing to operate with these audit findings is not an option.

It was the intent of prior PERF leadership, as documented in the May 24, 2004 response to the State Board of Accounts, that these findings would be resolved by now. The June 30, 2004 audit clearly shows that they are not. To continue to discuss what we are doing to resolve each specific finding without discussion of our intentions to resolve the core problems from my perspective is not valuable. Therefore, I want to take this opportunity to discuss our plans for resolving these findings.

First and foremost, I want to state that the State Board of Accounts and the CPA firms hired have found no fraudulent transactions. As I have reviewed PERF's approach to resolving issues in the past, I have determined that PERF personnel worked tactically to resolve issues. In other words, based upon a finding from the State Board of Accounts, PERF established measures to resolve that specific issue. Although some progress has been made, tactically resolving these issues will not solve PERF's problems. PERF staff have merely treated the symptoms and not addressed the root cause to the problem.

The leadership team at PERF will implement a comprehensive plan to resolve these issues. This plan will involve organizational changes, technological changes and establishing the appropriate internal control processes and procedures.

Our first step will be to examine our organization and perform a complete review of all of our business functions including the financial, information technology, human resources, operational, and customer delivery organizations.

PERF leadership and staff, with assistance from external firms, will review the organizational functions and structure to ensure that we have an organization in place that supports our business strategy and goals. Within the financial organization, PERF leadership will identify the business requirements and will obtain and match skill sets of our personnel and ensure that the appropriate tools are in place to operate effectively. Our information technology organization will review our business requirements and customer needs and drive our technological support based on those requirements and needs. Within our human resources function, PERF leadership will



identify and develop training for our staff, obtain and match skill sets to our business processes, review and update our hiring policies and establish a consistent process for evaluating our staff. Our operations and customer delivery functions will be reviewed and enhanced in support of our business objectives. Recommendations will be made and actions will be taken.

PERF leadership recognizes that technology is a tool to support our business goals, objectives and processes. Our leadership team will develop a comprehensive technology plan to support our business objectives. We will evaluate our current environment and determine the necessary changes. Recommendations will be made and actions will be taken.

Reviewing and revising our internal controls will ensure that the appropriate checks and balances are in place. Implementing an organizational and technological environment that supports our business objectives will address many of our internal control issues. Recommendations will be made and actions will be taken.

Implementation of this plan will require significant time and resources to resolve. Many of the issues that PERF is dealing with have a longstanding history. These issues are related to both systems as well as personnel issues and have been well documented by the State Board of Accounts through previous audit findings and confirmed by outside firms.

The complexity of the environment that we operate in creates many challenges for us and for our customers. However, our complexity does not change the fact that these audit findings exist. The PERF leadership team job will put us on a course such that these issues are permanently resolved. This will take time and as I write this letter I recognize that the next fiscal year audit process is less than two months away. As we move forward, we are committed to resolve these issues. By attacking the root cause, we will resolve both the problem and the symptoms associated with the problem.

Again, I want to thank the State Board of Accounts for their insight and assistance. PERF welcomes additional input from the State Board of Accounts, as we move forward, based upon their experience with our organization to address these issues.

Sincerely,

David J Adams
Executive Director

May 13, 2005

Charles Johnson, III, CPA
State Examiner
Indiana State Board of Accounts
302 W. Washington St. Room E418
Indianapolis, IN 46204

Dear Mr. Johnson:

Thank you for sending me the draft audit opinion of the State Board of Accounts for the Public Employees' Retirement Fund for Fiscal Year 2004. The hard work and professionalism of your staff on this audit are greatly appreciated. I welcome the opportunity to comment on the draft audit.

As you know, many of the challenges and problems at PERF have existed for decades. These challenges and problems did not happen overnight and will not all be fixed overnight. It will take much continued hard work by the PERF Board of Trustees and staff over the next several years to fix all of these problems. As a member of PERF for more than twenty years and its Executive Director for two years, I know that the staff is dedicated to improving services while simultaneously working hard to fix the problems identified in your draft audit.

Let me take this opportunity to make several specific observations about the draft audit that you were so kind to send me. First, I am very disappointed that PERF did not meet its ambitious goal of fixing the problems identified in your Fiscal Year 2003 Audit and which were repeated in your Fiscal Year 2004 Audit. I am confident, however, that much progress has been made to correct those problems because of the commitment of the Board, staff, and outside contractors. Second, the SBOA's qualified opinion of PERF's financial statements for the second year in a row is also very disappointing. This qualified opinion is especially disconcerting because of all the hard work by PERF staff and the investment of more than a million dollars in outside contractors to reconcile the reserve accounts. I was under the distinct impression that these reserve accounts had been materially reconciled for the fiscal year under review by the time of my resignation. Unfortunately, the SBOA has a different opinion. Finally, I am encouraged that the number of new findings has significantly decreased. While these problems will still be difficult to fix in the near future, continuous improvement is clearly underway at PERF.

As a result of the leadership of the Board of Trustees and the hard work of the staff over the last few years, PERF has significantly improved service to its members, their families and the more than 1100 participating employers. I am very confident that PERF will

continue to make progress on becoming a world class financial services institution. As a member and former employee, I expect no less.

Sincerely,

Craig E. Hartzer
11374 Bayhill Way
Indianapolis, IN
46236